BRIEF IN SUPPORT OF PETITION

ARGUMENT

Summary

POINT I

The Federal Courts are bound by the New York Law that the advance of monies to an executor, prior to Surrogate's approval required by statute, is illegal and the transaction a mere loan.

The Norman estate was administered in the courts of the State of New York. Fixing and paying executor's compensation are governed by Section 285 of the New York Surrogate's Court Act. This statute and the decisions thereunder clearly establish that an advance to an executor

preceding the Surrogate's decree is illegal. Therefore, the payments made to plaintiff in 1936 and 1937 were surchargeable, and in legal effect mere loans, despite any contrary intention of the parties.

The pertinent provisions of Section 285 of the Surrogate's Court Act are:

> "On the settlement of the account of any executor, * * * the Surrogate must allow to such executor, commissions, * * * for his services in such official capacity, and if there be more than one, apportion among them according to the services rendered by them respectively."

The courts have decided that the right of commissions under this and similar statutes depends upon the rendition of the service and the settlement of the account. Until both events have occurred, the executor is not legally entitled to commissions (*Oakeshott* v. *Smith,* 104 App. Div. 384; affd. 185 N. Y. 583, 78 N. E. 1108; *Beard* v. *Beard,* 140 N. Y. 260, 35 N. E. 488). Taking commissions in advance of the account is improper (*In re Bates' Estate,* 167 Misc. 641). Upon the making of such an advance payment, it is improper for an executor to set up credit in his accounts therefor (*In re Collins' Estate,* 158 Misc. 798). The monies so advanced are held to be the equivalent of cash on hand in the possession of the estate (*Matter of Dunkel, Jr.,* 10 N. Y. St. R. 213). Even in the absence of executing a note therefor, the executor receiving such an advance is liable to repay to the estate the amount thereof with interest (*Wheelwright* v. *Rhoades,* 28 Hun. 57). Under similar statutory provisions it was held that the executor taking such commissions in advance occupies the position of borrower of the amount so taken (*In re Jula's Estate,* 3 N. J.

Misc. 976; 130 A. 733, 735). Until the accounting, the right to commissions is incohate (*Matter of Worthington,* 141 N. Y. 9, 35 N. E. 929), and cannot therefore be assigned (*In re Furness,* 75 F. [2d] 965; *Lockhart* v. *Mittlemann,* 123 F. [2d] 703).

The trial court concluded as a matter of law (Conclusion of Law III, R. 239) that the payments made to plaintiff in 1936 and 1937 were illegal. Therefore, it necessarily follows that plaintiff did not have the right to demand nor the estate the obligation to make those payments. The conclusion is equally inescapable that under the laws of the State of New York, the legal effect of the transaction was to make plaintiff a borrower, and not to compensate him for personal services.

Other New York cases emphasize the executor's risk in taking any advance since there are many contingencies which may reduce or even remove the right to commissions when the time for the accounting arrives. Thus the New York courts have determined that despite the use of the word "must" in the New York statute, the Surrogate nevertheless has the right in his discretion to deny or substantially reduce commissions for inattention to duty (*Matter of Rutledge,* 162 N. Y. 31, 56 N. E. 511; *In re Sharp's Estate,* 140 Misc. 427), or for neglect or unfaithfulness (*Stevens* v. *Melcher,* 152 N. Y. 551, 46 N. E. 965) or in the event of death (*Matter of Bushe,* 227 N. Y. 85, 129 N. E. 154) or resignation (*In re Douglas,* 60 App. Div. 64). It has been further held that the amount of commissions depends on the rate prevailing at the time of the accounting (*In re Barker,* 230 N. Y. 364, 372, 130 N. E. 579; *Estate of Henry Harris,* 1 N. Y. St. R. 331; *Lewis* v. *Bowers,* 19 F. Supp. 745). Further risks in premature appraisal of commissions to justify an advance were taken by petitioner

because of the provision (§285 [5], see appendix) that the value of real or personal property is to be determined in such manner as the Surrogate directs, and also the provision (§285 [8], see appendix) that where there are three executors the commissions are apportioned among them according to the services rendered by them respectively.

In the instant case the contingencies were real inasmuch as the plaintiff's commissions might have been disallowed completely or cut substantially if he had died, resigned, been guilty of misfeasance, malfeasance, neglect or inattention to duty; or if the rate of compensation had materially changed; or if the Surrogate had directed the valuation of the real or personal property in a manner different than that adopted by the executors; or if large specific legatees, the guardians of the remaindermen, or creditors of the estate had protested against the allowances or had demanded surcharge for the illegal taking thereof. Furthermore, in this case the executors had agreed in 1936 as to the apportionment of fees among themselves (Ex. P, R. 15, 132; Finding of Fact 6, R. 230). This was subject to Surrogate's approval. The Surrogate in 1938 might very well have refused to adopt this agreement as to commissions. The taxability of improper advances should not be conditioned by subsequent developments in the administration of the estate.

The Court below erred in discounting the New York decisions on the theory that hindsight revealed that the decree of 1938 granted commissions in excess of the earlier advances. Whether the advances of 1936 and 1937 are income in those years must be determined by the character of the transaction at the time of their receipt. The existing interpretation by State Courts of the pertinent State

Statutes apply in the Federal Courts. *Commissioner* v. *Cadwalader,* 88 F. (2) 274, cert. den. 301 U. S. 706; cf. *Helvering* v. *Stuart,* 317 U. S. 154, 63 S. Ct. 140, 87 L. Ed. 109; *Blair* v. *Commissioner,* 300 U. S. 5, 57, S. Ct. 330, 81 L. Ed. 465.

The court below erroneously disregarded decisions of the New York courts establishing that in 1936 and 1937 the petitioner had no right to receive these funds. The effect of the New York law on executor's commissions was a legal fact to be considered by the court in determining the ultimate Federal question—in what year were the commissions received as income within the meaning of the Revenue Act.

POINT II

The decision in the Court below is in conflict with the decision in *Commissioner v. Cadwalader*, in the Third Circuit and with that of the Solicitor of Internal Revenue.

By §42 of the Revenue Act of 1934 and subsequent acts (26 U. S. C. A. §42) all items of gross income must be included "for the taxable year in which received by the taxpayer * * *" but the question remains—what is "gross income?" This term is defined in §22 of the Revenue Act (26 U. S. C. A. §22) to include "compensation for personal services * * * of whatever kind and in whatever form paid * * *." The authorities establish that the receipt of money is not the sole test of taxability; in the case of executor's commissions advances on commissions are not part of the taxable income in the year of receipt.

Commissioner v. *Cadwalader,* 88 Fed. (2) 274, cert. denied 301 U. S. 706, is on all fours with the instant case.

It deals with an estate administered under the New Jersey laws. Section 129 of the Orphans' Court Act of New Jersey (3 N. J. Comp. St. 1910, p. 3860, §129), which provides that:

> " 'The commissions of executors, * * * shall be determined by the Orphans' Court on the final settlement of their accounts * * *' "

has been construed as has been Section 285 of the Surrogate's Court Act of New York. Under the New Jersey law, just as under the New York law, executors are not entitled to fees or commissions until the final account is filed and the fees and commissions are allowed by the Orphans' Court. (*In re Smith's Estate,* 107 N. J. Eq. 607, 153 A. 647; *Titsworth* v. *Titsworth,* 107 N. J. Eq. 436, 152 A. 869; *Wyckoff* v. *O'Neil,* 72 N. J. Eq. 880, 67 A. 32.)

Because of the unliquid position of the estate, cash was borrowed and turned over to the executrices as advances on their commissions. The question presented was also in what year were such advances taxable, when received or when finally approved.

The Board of Tax Appeals at 32 B. T. A. 1157 held that the advances were taxable in the year of receipt. On appeal to the Circuit Court of Appeals for the Third Circuit, that court reversed the holding of the Board, maintaining that the advances were not deemed to have been received and hence not taxable until the year of court approval.

In S. M. 1925, IV-I, C. B. 125 the same conclusion was reached by the Solicitor of Internal Revenue where a Maine statute (see appendix) similar to the New York statute was involved. Executor estimated his commissions and withdrew securities in that amount from the estate. He executed in favor of the estate a non-interest bearing

note for the amount, to be held by the estate until the commissions were authorized by the court. The Solicitor determined that until court approval the taxpayer had no legal right to any commissions and therefore none were earned in advance of such approval.

In both of the aforementioned cases, the State statute governing executors' commissions was similar to the New York statute involved herein. In both cases in contradistinction to the decision in the court below the law of the particular state was looked to, to determine the character of the advance commissions. Also in both cases since the state laws held the advances, taken without the legal right to demand nor to receive, to be mere loans, the conclusion was reached that the advance on commissions were not compensation and hence not taxable in the year of receipt, but only when finally approved by the court.

We submit, therefore, that in view of the fact that the decision in the instant case is directly in conflict with a decision in the Third Circuit and with a decision of the Internal Revenue Department, for the purposes of uniformity this court should grant certiorari herein to determine finally the principle of law in question.

POINT III

The decisions cited in the Court below are clearly distinguishable from the instant case.

The lower court in its opinion has cited numerous decisions in support of its conclusion. A review of these cases indicates such sharp differences between them and the instant case so as to render them impotent as authority for the conclusions invoked in the court below.

The case of *North American Oil Consolidated* v. *Burnet, supra,* cited by the court below at 136 F. (2d) 956 (R. 249) has been dealt with at length in the petition herein (pp. 8-12). There it was shown that the "claim of right" doctrine as set forth in that case cannot apply to the instant case, for the reason that petitioner in 1936 and 1937, when he received the advances on commissions, did not have the legal right to demand, and the estate the legal obligation to pay same.

The rest of the cases cited by the court below in its decision fall into three main categories and are all readily distinguishable from the instant case.

In *Board* v. *Commissioner,* 51 F. (2) 73 (C. C. A. 6th) cited by the court below at page 956 (R. 250); *Mitchell* v. *Commissioner,* 89 F. (2) 873 (C. C. A. 2d) cited by the court below at page 957 (R. 250); *Saunders* v. *Commissioner,* 101 F. (2d) 407 (C. C. A. 10th) cited by the court below at page 957 (R. 250); *Griffin* v. *Smith,* 101 F. (2d) 348 (C. C. A. 7th); cert. denied 308 U. S. 561 cited by the court below at page 957 (R. 250) the respective taxpayers all received the moneys in question under a "claim of right" just as in the *North American Oil* case, *supra.* In each case, at the time of receipt there was a legal right in the recipients to demand the money and/or a duty in the payors to pay the money, even though later the recipients might have had to return the money for varied reasons, at which time a proper loss deduction could be taken. In the instant case, however, the estate was not under a duty to pay on the dates it did so. Indeed the estate was under a duty not to pay and the petitioner did not have the legal right to demand the advances.

In *National City Bank of New York* v. *Helvering,* 98 F. (2) 93 (C. C. A. 2d) cited by the court below at pages 956-7

(R. 250-1) and in *Barker* v. *Magruder*, 95 F. (2) 122, 68 App. D. C. 78, cited by the court below at pages 956-7 (R. 250-1) the question was presented when illicit income should be reported. It was held in the first case where the taxpayer reported on the cash receipt basis that it be reported in the year of receipt and in the second case where the taxpayer reported on the accrual basis that it be reported in the year that the income accrued. This is sound reasoning. When else should a tort feasor be taxed for illicit gains other than in the year of receipt or accrual as the case may be. The taking in such cases could never become legal so as to be taxable in the year of validation while in the instant case the advance though improper when taken was validated upon judicial decree on accounting.

In *United States* v. *S. S. White Dental Mfg. Co.*, 274 U. S. 398, 47 S. Ct. 598, 71 L. Ed. 120 cited by the court below at page 956 (R. 250) and in *Brown* v. *Helvering*, 291 U. S. 193, 199, 54 S. Ct. 356, 78 L. Ed. 725, cited by the court below at page 956 (R. 250) the question before the courts was whether certain deductions could properly be taken by the respective taxpayers in particular years. In the first case, the taxpayer, a corporation took a loss in 1918 when its property was sequestered by the German government. In 1922 some recovery was had reducing the loss reported. The court maintained that the possibility of recovery in 1918 was so negligible so as to justify the deduction taken.

In the instant case, however, the petitioner could not at all be sure that at a future date the Surrogate would approve the commissions he advanced himself. There existed too many uncertain contingencies which would have to be disposed of before final judicial approval (see p. 16, *supra*).

In the second case, an insurance agent accounting on the accrual basis wanted to deduct from the amount of commissions which he received on business written during the year, the amount which in view of past experience he anticipated he would be called upon to refund in future years on account of cancellations. The court refused to allow this deduction, holding that the contingencies did not affect the income quality of the commissions received since when received the "general agent's right to it was absolute." However, in the case at bar, the right of petitioner to the advances was far from absolute; in fact his receipt of the advances was illegal and improper and in effect but a loan.

It is evident, therefore, that though the decisions in the aforementioned cases are justifiable when viewed from the perspective of their respective facts, they can have no application to the instant case.

CONCLUSION

For the reasons heretofore assigned, it is respectfully submitted that the case is one which justifies the issuance of a writ of certiorari.

Respectfully submitted,

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